

Message Text

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INFO OCT-01 ISO-00 SPC-03 AID-20 EB-11 NSC-07 RSC-01

CIEP-02 TRSE-00 SS-20 STR-08 OMB-01 CEA-02 CIAE-00

COME-00 FRB-02 INR-10 NSAE-00 XMB-07 OPIC-12 LAB-06

SIL-01 DODE-00 PM-07 H-03 L-03 PA-04 PRS-01 USIA-15

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R 291843Z MAR 74 ZDK
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TO SECSTATE WASHDC 9189
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
AMEMBASSY COPENHAGEN
AMEMBASSY DUBLIN
AMEMBASSY THE HAGUE
AMEMBASSY LUXEMBOURG
AMEMBASSY PARIS
AMEMBASSY ROME
USMISSION EC BRUSSELS
USMISSION NATO BRUSSELS
USMISSION OECD PARIS

C O N F I D E N T I A L SECTION 01 OF 02 LONDON 04034

E.O. 11652: GDS

TAGS: PINT, PFOR, UK

SUBJECT: QUARTERLY TREND REPORT - UNITED KINGDOM (FIRST
QUARTER 1974)

1. SUMMARY: THE NEW MINORITY LABOR GOVERNMENT HAS TAKEN
OFFICE WITH SELF-ASSURANCE AND VIGOR, BUT IS UNDER
PRESSURE TO HOLD ANOTHER GENERAL ELECTION SOON -
POSSIBLY AS EARLY AS JUNE. THE ECONOMIC OUTLOOK FOR
THE UK IS BLEAK, AND IS LIKELY TO FEATURE TRADE
DEFICITS, INCREASED UNEMPLOYMENT, DECREASED BUSINESS
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INVESTMENT, AND HIGH INFLATION. THIS WILL MAKE IT

ESPECIALLY DIFFICULT FOR THE TRADE UNIONS TO UPHOLD THEIR MUCH-TOUTED "SOCIAL CONTRACT" WITH THE GOVERNMENT TO RESTRAIN WAGE DEMANDS.

2. IN FOREIGN AFFAIRS, THE NEW GOVERNMENT IS GIVING PRIORITY TO ITS RELATIONS WITH THE UNITED STATES. IT IS ALSO COMMITTED TO CLOSER US-EUROPEAN TIES. FOREIGN SECRETARY CALLAGHAN HAS SET OUT TO RENEGOTIATE THE TERMS OF BRITISH EC MEMBERSHIP CONSTRUCTIVELY AND PRAGMATICALLY, BUT IT IS STILL AN OPEN QUESTION WHETHER BRITAIN WILL ULTIMATELY REMAIN IN OR WITHDRAW. END SUMMARY

3. NEW GOVERNMENT: PERFORMANCE AND PROSPECTS - THE NEW LABOR GOVERNMENT IS OFF TO A STRONG START. IT HAS TAKEN OFFICE WITH A SELF-ASSURANCE AND VIGOR THAT BELIE ITS MINORITY POSITION IN PARLIAMENT. IN FULFILLMENT OF ITS CAMPAIGN PROMISES, IT HAS FROZEN RENTS, INITIATED FOOD SUBSIDIES, TIGHTENED PRICE CONTROLS, RAISED PENSIONS AND SOCIAL SECURITY BENEFITS, MADE A START TOWARDS REDISTRIBUTING WEALTH IN FAVOR OF THE LOWER-PAID, AND ANNOUNCED A TIMETABLE FOR REPEAL OF THE INDUSTRIAL RELATIONS ACT. THESE MEASURES ARE ELECTORALLY SAFE. THEY ALSO GO FAR TOWARDS UPHOLDING THE GOVERNMENT'S END OF ITS FABLED "SOCIAL CONTRACT" WITH THE TRADE UNIONS. CRITICAL TO THE FUTURE SURVIVAL OF THE GOVERNMENT WILL BE THE UNIONS' READINESS AND ABILITY TO RESTRAIN WAGE DEMANDS AS THEIR PART OF THE CONTRACT.

4. THE OPPOSITION IS MOMENTARILY IN A STATE OF DISARRAY. PRIME MINISTER WILSON SHOULD ENJOY RELATIVELY CLEAR SAILING IN PARLIAMENT SO LONG AS HE STICKS TO A LEGISLATIVE PROGRAM THAT ENJOYS A FAIR MEASURE OF POPULAR SUPPORT AND SO LONG AS HIS EFFORTS TO COMBAT INFLATION ARE SEEN TO BE EFFECTIVE. THESE ARE TWO FORMIDABLE STIPULATIONS, HOWEVER. IT WILL BE ONLY A MATTER OF MONTHS BEFORE THE LEFT WING OF THE LABOR PARTY -- WHICH IS STRONGER IN THIS PARLIAMENT THAN THE LAST -- WILL BEGIN TO PRESS WILSON TO IMPLEMENT THE MORE RADICAL ELEMENTS IN LABOR'S PROGRAM, INCLUDING EXTENSION OF PUBLIC OWNERSHIP AND CONTROL OVER INDUSTRY. IT ALSO

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FLIES IN THE FACE OF ALL RECENT EXPERIENCE TO EXPECT A VOLUNTARY INCOMES POLICY TO HOLD UP FOR VERY LONG, NO MATTER HOW WELL INTENTIONED SOME UNION LEADERS MAY BE.

5. WILSON WILL THEREFORE WANT TO WEIGH VERY CAREFULLY THE ADVANTAGES AND DISADVANTAGES OF CALLING ANOTHER GENERAL ELECTION -- POSSIBLY AS EARLY AS JUNE. HE MIGHT BE TEMPTED TO CAPITALIZE ON THE GLOW OF HIS

HONEYMOON PERIOD TO SEEK A CLEAR LABOR MAJORITY BEFORE THE CONSEQUENCES OF BRITAIN'S ECONOMIC CRISIS BEGIN TO PINCH. UNLESS THE OPPOSITION PARTIES HAD BEEN CAPRICIOUSLY OBSTRUCTIONIST, HOWEVER, HE WOULD RISK THE ELECTORATE'S DISPLEASURE FOR NEEDLESSLY PRECIPITATING ANOTHER ELECTION, ESPECIALLY IN THE ABSENCE OF ANY POPULAR DEMAND FOR LABOR'S RADICAL PROGRAM.

6. ECONOMIC OUTLOOK - THE ECONOMIC OUTLOOK IN THE US FOR 1974 IS POOR. A WEAKENING IN THE LATTER HALF OF 1973 WAS EXACERBATED BY THE OIL CRISIS AND IN EARLY 1974 BY THE COAL MINERS' ACTION LEADING TO THE THREE-DAY WORK WEEK. OUTPUT IN THE UK WAS DOWN BY ABOUT 20 GDS
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PERCENT IN THE FIRST QUARTER IN 1974. IN 1973 AND EARLY 1974, THE UK EXPERIENCED INCREASINGLY HEAVY TRADE DEFICITS. THE OIL PRICE INCREASES WILL PLACE INCREASING PRESSURE ON THE DEFICIT. THE NEW LABOR GOVERNMENT HAS SETTLED THE COAL STRIKE AND RESTORED INDUSTRY TO A FULL TIME BASIS. OIL IS NO LONGER A PROBLEM, BUT MUCH OF THE SECOND QUARTER AND THIRD QUARTER OF THIS YEAR WILL BE MAKE-UP. BY THE END OF THE YEAR, OUTPUT CAPACITY GROWTH MAY HAVE RETURNED TO NORMAL.

7. HOWEVER, THE OIL PRICE RISES PLUS BUDGET CUTS TO
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REDUCE DEMAND MADE BY THE CONSERVATIVE GOVERNMENT IN DECEMBER 1973 (WHEN IT WAS BELIEVED THAT OIL SHORTAGES WOULD CONSTRAIN OUTPUT CAPACITY) MAY NOW WORK TO WEAKEN DEMAND IN THE LATTER PART OF THIS YEAR. IN SPITE OF THIS, THE LABOR GOVERNMENT HAS PRESENTED A DEFLATIONARY BUDGET TO RESTRAIN DOMESTIC DEMAND, INCREASE EXPORTS, REDUCE IMPORTS, AND MAINTAIN INTERNATIONAL CONFIDENCE IN THE BRITISH ECONOMY TO PERMIT FOREIGN BORROWING TO COVER THE EXTERNAL DEFICIT. IT IS POSSIBLE, HOWEVER, THAT THE IMPACT OF THIS BUDGET COULD BE MORE DEFLATIONARY THAN THE GOVERNMENT ENVISAGES, AND ECONOMIC ACTIVITY MAY WELL SLOW APPRECIABLY AND UNEMPLOYMENT MAY RISE TO A RELATIVELY HIGH LEVEL, ESPECIALLY IF BUSINESS CONFIDENCE IS POOR AND INVESTMENT PLANS ARE POSTPONED.

8. INFLATION WILL BE A MAJOR PROBLEM IN ANY CASE. THE OIL RISES AND OTHER RISING COMMODITY PRICES HEAVILY INFLUENCE PRICES IN THE UK. BEYOND THAT, DEMAND PRESSURES FROM 1973 AND THE LARGE WAGE RISES (ESPECIALLY TO THE MINERS), THE FUNCTIONING OF THE WAGE PRICE CONTROL PROGRAM, THE INCREASING COST OF COAL, ELECTRICITY, AND OTHER LOCAL PRODUCTION MATERIALS IMPLY RETAIL PRICE RISES OF AT LEAST 15 PERCENT IN 1974. THE NEW GOVERNMENT IS TRYING TO OFFSET THIS MAINLY THROUGH FOOD SUBSIDIES AND TIGHTENING THE PRICE CODE, WHICH WILL FURTHER LIMIT PROFIT MARGINS, BUT ITS BUDGET WILL ACTUALLY EXACERBATE INFLATION.

9. FOREIGN AFFAIRS - THE MOST STRIKING ASPECT OF THE NEW GOVERNMENT'S FOREIGN POLICY IS ITS FIRM INTENTION TO SEEK VERY CLOSE TIES WITH THE UNITED STATES. IT FAVORS THE FULLEST CONSULTATION AND COOPERATION NOT

ONLY BETWEEN THE UK AND THE US, BUT ALSO BETWEEN THE EC AND THE US. THIS OPENS OPPORTUNITIES FOR TRANS-MUTING THE SPECIAL BILATERAL US-UK RELATIONSHIP OF THE PAST INTO CLOSER TRANS-ATLANTIC TIES. BRITAIN SHARES WITH US THE CONVICTION THAT THERE IS NO INCOMPATIBILITY BETWEEN FIRM INTRA-EUROPEAN TIES AND FIRM TRANS-ATLANTIC TIES, AND WILL STRIVE TO PREVENT SITUATIONS ARISING WHICH POSE A CHOICE BETWEEN THE TWO.

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10. THE NEW GOVERNMENT REMAINS A STAUNCH DEFENDER OF NATO, AND CAN BE EXPECTED TO RESIST SUCCESSFULLY PRESSURES FROM THE LEFT WING OF THE LABOR PARTY TO REDUCE DEFENSE EXPENDITURES DRASTICALLY OR SEEK THE REMOVAL OF NUCLEAR BASES FROM THE UK.

11. FOREIGN SECRETARY CALLAGHAN REGARDS RENEGOTIATION OF BRITISH EC MEMBERSHIP AS A SERIOUS EFFORT TO SECURE MORE FAVORABLE TERMS AND NOT AS A PRETEXT FOR WITHDRAWAL. HE WILL CONDUCT THE EXERCISE PRAGMATICALLY, FOCUSING ON TRYING TO GET ALTERATIONS IN CAP, REDUCTIONS IN BRITAIN'S CONTRIBUTIONS TO THE EC BUDGET, AND BETTER ACCESS TO EC AGRICULTURAL MARKETS BY OUTSIDE SUPPLIERS. LABOR ANTI-MARKETEERS, OF COURSE, WILL BE SATISFIED WITH NOTHING ELSE THAN A FUNDAMENTAL REVISION OF THE TREATY OF ACCESSION. SOONER OR LATER, THERE WILL HAVE TO BE A SHOWDOWN ON THIS ISSUE WITHIN THE PARTY, BUT WILSON WILL PROBABLY TRY TO POSTPONE IT UNTIL AFTER THE NEXT GENERAL ELECTION. REGARDLESS OF HOW THAT FIGHT IS RESOLVED, A FINAL UNCERTAINTY IS POSED BY WILSON'S PLEDGE TO PUT THE RESULTS OF RENEGOTIATION TO THE BRITISH PEOPLE, MANY OF WHOM REMAIN UNENTHUSIASTIC ABOUT EC MEMBERSHIP.

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